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# Encouraging Research and Development (and Innovation) in the Spanish Tax System

**This article examines the tax system for research and development (and innovation) (R&D (&I)) in Spain. Generally, the Spanish tax system encourages R&D (&I) by granting a wide range of incentives with regard to R&D (&I), as companies may benefit from input and output incentives in respect of such activities.**

## 1. Introduction

According to the OECD, research and development (and innovation) (R&D (&I)) are key to productivity and growth.[1] The Europe 2020 strategy has R&D (&I) at its core with the objective of realizing an overall R&D (&I) spending of 3% of GDP.[2] With regard to Spain, the objective is also to increase R&D (&I) spending to 3% of its GDP. According to Eurostat's data, in November 2014, R&D (&I) spending in Spain was 1.24% of its GDP.[3]

It is generally understood that market incentives alone are insufficient to produce an adequate supply of R&D (&I) and, if there is not an opportunity for profit, R&D (&I) will not be undertaken by entities. As a result, state intervention is essential to stimulate private R&D (&I) spending by way of subsidies, taxes, trade or other policies and to influence the generation of research and knowledge for sustainable economic growth.[4]

Governments define the tax system, but they can also implement special measures to encourage entities to carry on particular types of businesses in their territories, extra fiscal objectives. The introduction of tax incentives to encourage R&D (&I) is, therefore, a tax policy decision. In terms of tax competition, countries may introduce special fiscal measures under a defensive or aggressive approach. On the one hand, technology-exporting countries normally introduce measures that are intended to retain intangibles and related intellectual property (IP) rights. Consequently, the objective for these countries is to counter the location of highly mobile capital in low-tax jurisdictions. On the other hand, technology-importing, or developing, countries adopt an aggressive position with the purpose of attracting intangibles and related IP rights, i.e. to encourage entities to undertake certain economic activities in their territories.

For several years, Spain has been one of the developed countries with less investment in R&D (&I) compared to the average for European countries. It should also be noted that R&D (&I) in Spain has traditionally come from the public sector, while the Spanish business world has broadly been technology-importing. As a result, the Spanish *Ley del Impuesto sobre Sociedades* (Corporate Income Tax Law, LIS)[5] grants both input and output incentives to companies as defined (*see* sections 2. and 3.) with the objective of increasing the amount of R&D (&I) investment in the Spanish private sector.

As input and output incentives are granted, there is room for both protecting and promoting R&D (&I). However, this broad scope can be questioned in light of the principles of tax fairness as enshrined in article 31 of the Spanish Constitution. The existence of input and output incentives implies an additional reason for companies to invest in R&D (&I) as well as to exploit IP rights, but this may result in the loss of public revenue.

## 2. The Tax Credit for R&D (&I) Activities

Spain has traditionally granted a tax credit in respect of expenditure on R&D (&I) to companies carrying out this type of activities. Since 2000, a tax credit on technological innovation has also been granted. Consequently, article 35 of the LIS provides a tax credit for R&D (&I), in allowing the deduction of a percentage of R&D (&I) expenditure.

Following the OECD's *Frascati Manual* of 2002,[6] article 35 of the LIS defines research as:

> an original planned investigation in order to discover new knowledge and superior understanding in the field of Science and Technology (S&T).[7]

Next, "development" implies:

> the application of research findings or any other scientific knowledge to manufacture new materials or products or to design new

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1. OECD, *Supporting Investment in Knowledge Capital, Growth and Innovation* (OECD 2013).
2. Europe 2020 – A strategy for smart, sustainable and inclusive growth, COM (2010) 2020 (Mar. 2010).
3. Data are available at the Eurostat's site: http://ec.europa.eu/eurostat/web/science-technology-innovation/statistics-illustrated (accessed 13 June 2016).
4. In the same vein, according to R.J. Danon, *General Report*, in *Tax Incentives on Research and Development (R&D)*, International Fiscal Association (IFA) *Cahiers de Droit Fiscal International* vol. 100a, sec. 1. (Sdu Uitgevers 2015), Online Books IBFD, "[s]tate intervention to stimulate R&D is justified because there is broad agreement that without such intervention undertakings will tend to underinvest in R&D compared to the appropriate level of spillovers that R&D may generate for society". *See also* Å. Hansson & C. Brokelind, Tax Incentives, *Tax Expenditures Theories in R&D: The Case of Sweden*, 6 World Tax J. 2, sec. 3. (2014), Journals IBFD.
5. ES: *Ley del Impuesto sobre Sociedades* (Corporate Income Tax Law, LIS).
6. OECD, *Frascati Manual* (OECD 2002).
7. All quotations of Spanish law and regulations are the authors' unofficial translations.

> production processes or systems, as well as to obtain substantial technological improvement of pre-existing materials, products, systems and processes.

Finally:

> technological innovation is an activity whose result is a technological advance in getting new products or production processes, or substantial improvements of the preexisting products or production processes.

While innovation, i.e. subjective novelty, requires a result, R&D (&I), i.e. objective novelty, does not require any result.

On the other hand, article 35.3 of the LIS excludes some activities that are not considered to be R&D (&I) for tax purposes. These include the following three activities: (1) all activities that do not involve significant scientific or technological innovation, such as routine efforts to improve the quality of products or processes; (2) the industrial production and the service provision or distribution of goods and services, i.e. quality control and the standardization of products and processes; and (3) the exploration, drilling or prospecting for minerals and hydrocarbons.

Clarity, consistency and predictability are essential in assisting companies in making investment decisions with regard to R&D (&I) partly on the basis of tax incentives.[8] In this regard, it should be noted that the decision of the Spanish *Audiencia Nacional* (National Court, AN) of 20 June 2013[9] highlights the following three issues: (1) the indeterminate nature of the concept of R&D (&I); (2) the overuse of generic formulas and confusing terms to define either the concept or its exceptions;[10] and (3) a requirement of novelty may also rise in opposite interpretations due to the use of lax terms, such as an "original investigation" or "new knowledge", i.e. a narrow interpretation would imply a lack of novelty and, therefore, the denial of the tax incentive, while investment in R&D (&I) would be favoured under a broad approach.

Given the conceptual ambiguity and the difficulty in identifying qualifying R&D (&I) activities, the Spanish *Dirección General de Tributos* (General Directorate of Taxes, DGT) has issued numerous tax rulings regarding this issue.[11] In this vein, article 35.4 of the LIS lists the following three ways of providing legal certainty to taxpayers: (1) reasoned reports of the Spanish *Ministerio de Ciencia e Innovación* (Ministry of Science and Innovation) that qualifies certain activities as R&D (&I), with a binding effect on the tax administration; (2) tax consultations, or tax rulings[12] regarding the interpretation and application of the R&D (&I) tax credit; and (3) advance pricing agreements (APAs) relating to expenses and investment with regard to R&D (&I).

As a result, companies carrying out eligible R&D (&I) activities for tax purposes may apply for the tax credit set out in article 35 of the LIS. Qualifying R&D (&I) activities must be carried out in Spain or in a Member State of the European Union or the European Economic Area (EEA).

Article 35.1 of the LIS grants a volume-based credit based on R&D (&I) expenditure incurred in a fiscal year, in allowing 25% of R&D (&I) expenditure to be deducted from Spanish *Impuesto sobre Sociedades* (corporate income tax). Where R&D (&I) expenditure in a given fiscal year exceeds the average value of R&D (&I) expenses of the previous two fiscal years, the surplus amount benefits from a 42% incremental-based credit. Consequently, the Spanish legislator has decided in favour of a mixed-based credit. There is also a 17% additional deduction in respect of payroll expenses relating to qualified researchers used on a full-time basis in R&D (&I) activities and an 8% deduction in respect of investment in tangible and non-tangible assets related to R&D activities, excluding real estate and land. In addition, article 35.2 of the LIS allows a 12% deduction in respect of technological innovation.

Another issue, i.e. expenses relating to R&D (&I) activities contracted, or subcontracted, individually by a taxpayer or in collaboration with other companies, may be included in the base in respect of the tax credit if the R&D (&I) activities have been carried out in Spain or in another Member State of the European Union or the European Economic Area.[13] With regard to the tax credit on innovation, article 35.2 b) of the LIS permits the inclusion in the incentive base of the costs of acquiring technology, such as patents, licences, know-how and designs. In conclusion, a taxpayer may, on the one hand, outsource R&D (&I) activities and, on the other, acquire given IP assets, subject to territorial conditions.

## 3. The Spanish Patent Box Regime

### 3.1. In general

In 2007, Spain introduced a patent box regime by way of allowance in the corporate income tax base, with full effect from January 2008.[14] The introduction of this regime in article 23 of the LIS was based on the need to encourage

8. OECD, *Tax Incentives for Research and Development: Trends and Issues* (OECD 2002).
9. ES: AN, 20 June 2013, Case No. 2751.
10. *See also* ES: AN, 30 May 2011, Case No. 2703 and ES: AN, 9 Dec. 2010, Case No. 5764.
11. F. Alonso Murillo, *Fiscalidad de la I+D+i. Tratamiento de los gastos en el Impuesto sobre Sociedades* p. 35 (Netbiblo 2010).
12. In Spain, tax rulings, under articles 88 and 89 of the *Ley General Tributaria* (General Tax Law, LGT) allow taxpayers to make requests to the tax administration regarding the application of tax law in respect of the R&D (&I) regime, classification or tax category. As a result, tax rulings are how taxpayers can be provided by the tax administration with the necessary assistance and information to meet their tax obligations. In this respect, it should be noted that tax rulings are not agreements between the tax administration and taxpayers, but are published on the "open-access" database of the DGT.
13. Art. 35.1 b) LIS.
14. ES: *Ley* (Law) 16 of 4 July 2007. In this context, it should be noted that, in Spain, together with the common system of the corporate income tax, there are certain regions, i.e. Guipúzcoa, Biscay, Alava and Navarre, with their own regional "*fueros*" (laws). That is, these regions have their own corporate income tax. In this way, ES: *Norma Foral 2/2014, de 17 de enero, sobre el Impuesto de Sociedades del Territorio Histórico de Gipuzkoa*, art. 37 includes a tax allowance related to the exploitation of IP. Similarly, ES: *Norma Foral 11/2013, de 5 de diciembre, del Impuesto sobre Sociedades del Territorio Histórico de Bizkaia*, art. 37 grants a tax allowance relating to the exploitation of IP and ES: *Norma Foral 37/2013, de 13 de diciembre, del Impuesto sobre Sociedades del Territorio Histórico de Álava*, art. 37 regulates the IP regime. Finally, in Navarre, the *Ley Foral 24/1996, de 30 de diciembre, del Impuesto sobre Sociedades*, art. 37 establishes a patent box regime.

innovative activities in business, to promote the internalization of companies and to reduce the technological dependence of such enterprises. In addition, *the Exposición de Motivos de la Ley 16/2007* (Explanatory Memorandum to Law 16, 4 July 2007)[15] deals with the compatibility between the new patent box regime and the traditional tax credit in respect of R&D (&I) expenditure under article 35 of the LIS. Consequently, tax expenditure is extended to encompass R&D (&I) intangibles, thereby covering all of the R&D (&I) process ("from the idea to the market").

There are no temporal restrictions to benefit from this incentive and it can be applied for by all kinds of companies. This means that the patent box regime is compatible with the EU State aid rules, as it does not have the character of a selective measure.[16]

According to some of the data provided by the tax administration, in its first five-year period, i.e. 2008 to 2013, few companies benefited from the patent box regime. For instance, in the period 2011 to 2013, almost 20,000 companies undertook R&D (&I) activities according to the Spanish *Instituto Nacional de Estadística* (Statistical Office, INE). However, on average, only 173 companies applied for the patent box regime in the tax periods 2011 to 2013.[17] A large number of companies, mainly small and medium-sized enterprises (SMEs), encountered various difficulties in implementing the patent box regime, such as, inter alia, with regard to their organizational structures and contractual relationships that were necessary for the use of the regime, but with no real connection with market conditions and business or uncertainty due to the lack of certifications regarding projects.

With the purpose of making the patent box regime more attractive for innovation, the *Ley de Emprendedores* (Encouragement of Entrepreneurs Law)[18] amended the regime in September 2013. Consequently, the patent box regime now not only covers income from licences, but also income derived from transfers and the base in respect of the allowance relates to net income rather than gross income. The legal certainty is also guaranteed by the possibility to request an APA from the tax administration relating to the income earned in respect of a licence or the transfer of an asset and to the expenses so generated.

Finally, the General State Budget for 2016[19] amended the patent box regime to harmonize it with the agreements adopted within the European Union and by the OECD.[20] The new patent regime has full effect from July 2016. As a result, new entrants cannot have benefited from the previous patent box regime, which is inconsistent with the OECD's nexus-based approach, after 30 June 2016. This Law also has a grandfathering clause, which permits all taxpayers benefiting from the previous patent box regime to retain such an entitlement to 30 June 2021. After that date, no more benefits based on the previous, and inconsistent regime, will be granted to taxpayers.

### 3.2. Qualifying taxpayers

As noted in section 3.1., all types of companies may apply for the patent box regime. Under article 7 of the LIS, taxpayers, for corporate tax purposes, consist, inter alia, of the following seven types: (1) legal persons, except for civil law companies with no commercial form; (2) agricultural processing companies; (3) investment funds; (4) temporary joint ventures; (5) venture capital funds and collective investment undertakings, i.e. of a closed-end type; (6) pension funds; and (7) guarantee funds. It should also be noted that non-resident companies which derive income in Spain through permanent establishments (PEs) also qualify for the patent box regime.[21] In addition, the patent box regime applies to group companies. In this vein, the Encouragement of Entrepreneurs Law introduced into article 23.4 of the LIS the obligation for the companies in a tax consolidation to document all of the transactions associated with the application of the patent box regime, according to the Spanish transfer pricing rules. However, the current LIS[22] abolishes this provision. Consequently, the question is whether this obligation has really been abolished or is implicitly required.

With regard to self-employed individuals, such individuals do not, in practice, apply to use the patent box regime. Self-employed individuals are not considered to be taxpayers for corporate income tax purposes, unless they carry out their economic activities in the form of a legal entity. As a result, individual entrepreneurs are subject to *Impuesto sobre la Renta de las Personas Físicas* (individual income tax) and, as not being corporate income taxpayers, cannot benefit from article 23 of the LIS. However, the *Ley del Impuesto sobre la Renta de las Personas Físicas* (Individual Income Tax Law, LIRPF)[23] states that individual entrepreneurs may use the *estimación directa* method, instead of the *a forfait* method, to calculate the tax base.[24] This means

15. ES: *Exposición de Motivos de la Ley 16/2007, de 4 de julio, de reforma y adaptación de la legislación mercantil en materia contable para su armonización internacional con base en la normativa de la Unión Europea* (Explanatory Memorandum to Law 16, 4 July 2007).
16. European Commission, State aid N 480/2007 – Spain – The reduction of tax from intangible assets, C(2008)467 final (13 Feb. 2008).
17. Data on the number of companies applying for the patent box regime are published by the tax administration in the context of the *Estadística por partidas del Impuesto sobre Sociedades* at http://www.agenciatributaria.es.
18. ES: *Ley 14/2013, de 27 de septiembre, de apoyo a los emprendedores y su internacionalización (BOE núm. 233, de 28 de septiembre de 2013)* (Encouragement of Entrepreneurs Law).
19. ES: *Ley* (Act) 48 of 29 October 2015.
20. These amendments were announced in early August 2015 when the Spanish Finance Minister presented the project for the General State Budget for 2016 to the Parliament, i.e. a few months before the publication of OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance – Action 5: Final Report* (OECD 2015), International Organizations' Documentation IBFD.
21. ES: *Ley del Impuesto sobre la Renta de No Residentes* (Law on Income Tax on Non-Residents, LIRNR), art. 5.
22. ES: *Ley* (Law) 27 of November 2014.
23. ES: *Ley del Impuesto sobre la Renta de las Personas Físicas* (Individual Income Tax Law, LIRPF).
24. According to article 30.1 of the LIRPF, in general, the method for the calculation of the tax base with regard to the net income derived from economic activities is the *estimación directa* method. Article 31 of the LIRPF provides for the *a forfait* method with regard to certain types of activity. In practice, a large number of individual entrepreneurs use this method. The criteria for using one or another method depends on the trade volume and the kind of activities performed. As a result, the *estimación directa* method is compulsory for those individual entrepreneurs who cannot apply the *a forfait* method or for those who, in meeting the relevant the requirements, opt for it.

that net profits are calculated according to the provisions of the LIS. As a result, in such cases, self-employed individuals may be able to access the patent box regime.

Consequently, article 23 of the LIS provides for a tax allowance that is open to all entities that meet some of the conditions established in the provision. In particular:

(1) The assignee or the recipient of the IP asset must use the asset or the IP rights in the development of an economic activity. The results of this use must not involve the delivery of goods or the provision of services that implies deductible expenses for the assignor entity, when both are related parties.

(2) The assignee or the recipient of the IP asset must not be resident in a tax haven, unless such residence is located in the European Union and the user can demonstrate that there are valid economic reasons underlying the transaction.[25]

(3) If the licence contract includes the provision of other services, i.e. technical services, it is necessary to differentiate between such services and the main transaction.

(4) It is necessary to maintain accounting records that permit the determination of the relevant income and expenses from the licence or transfer of the IP asset.[26]

### 3.3. Eligible IP assets

The first question that arises in designing an output incentive is the identification of IP rights or IP assets that can benefit from the incentive. In this context, article 23 of the LIS defines the scope of IP in respect of the patent box regime from a positive and a negative perspective.[27] That is, the law not only refers to the eligible IP assets, but also expressly to those assets which, in spite of their high creative value, do not benefit from the patent box regime.

From a positive perspective, the patent box regime is available in respect of "patents, drawings or models, plans, secret formulas or processes".[28] This kind of IP assets may have access to public registers and its protection is covered by different IP laws. However, such access is independent for the eligibility of the incentive according to the administrative practice.[29]

Article 23.1 of the LIS, in fine, refers to "undisclosed information with industrial, commercial or scientific value", i.e. know-how, as forming part of the scope of IP for the patent box regime.[30] Know-how is closely linked to patents, as it permits the development of an industrial process with commercial undisclosed information and precisely this use makes the process more valuable in terms of innovation. In Spain, in meeting some requirements, inventions can be patented, but other types of inventions cannot be patented per se or if there is no interest in patenting such invention from the perspective of the undertaking company.[31] The problem, therefore, in relation to know-how is, on the one hand, the lack of a legal definition in the Spanish system and, on the other, the difficulties of distinguishing know-how from technical services.[32] Spanish administrative practice has also, inter alia, accepted the following three items as falling within the scope of IP: (1) algorithms created by a company in undertaking the R&D (&I) process; (2) related know-how; and (3) a new treatment in respect of an illness.

From a negative perspective, article 23.4 of the LIS explicitly excludes the following six items from the application of the patent box regarding the transfer or licensing of: (1) trademarks; (2) literary, artistic or scientific works; (3) industrial equipment; (4) image rights; (5) computer programs; and (6) other rights or assets not referred to in article 23.1 of the LIS.[33] Given administrative practice, the following four items cannot be considered to be eligible IP assets: (1) the provision of technical services; (2) the supply of computer software; (3) distinguishing signs or marks; and (4) the provision of technological expertise with regard to the assembly and installation of a new industrial plant.[34]

As a result, the scope of IP in respect of the patent box regime can be regarded as having adopted a "narrow approach", as it covers trade intangibles and expressly excludes marketing intangibles. Administrative practice also indicates certain other kinds of categories, for example, algorithms, that, even though they are not specifically patents or similar IP assets, are "functionally equi-

25. With regard to the regional patent box regimes in Guipúzcoa, Biscay, Alava and Navarre, conditions (1) and (2) must be met in order to be eligible for the regimes.
26. Together with these conditions, the former patent box regime also required that, at least, the undertaking had created the assets or the IP rights in respect of 25% of the cost. This requirement has been abolished in respect of the new patent box regime.
27. With regard to regional patent box regimes, i.e. those in Guipúzcoa, Biscay, Alava and Navarre, the scope in relation to IP is expressly determined from a negative perspective. Specifically, with regard to Guipúzcoa, Biscay and Navarre, the patent box regime does not apply to: (1) literary, artistic or scientific works; (2) industrial equipment; (3) image rights; and (4) computer programs. With regard to Alava, as well as these conditions, the patent box regime does not apply to trademarks. Consequently, *a sensu contrario*, the regional patent box regimes can be applied to any IP asset not expressly excluded from its scope.
28. Art. 23.1 LIS.
29. ES: DGT, Tax Ruling No. V1881-12.
30. According to ES: DGT, Tax Ruling No. V2788-15, know-how, which is considered to be industrial, commercial or scientific information, is not part of the scope of the IP in respect of the patent box regime in article 23 of the LIS.
31. For instance, in the United States, the Discussion Draft on US: Innovation Promotion Act of 2015 defines "Qualified Intellectual Property" as being patents, inventions, formulas, processes, designs, patterns and know-how, and property produced using such IP. As a result, the scope of the qualifying IP is not only includes patents, but also know-how and other kinds of inventions. For further information on the Discussion Draft in permitting a deduction for innovation box profit, *see* http://boustany.house.gov/114th-congress/boustany-neal-release-innovation-box-discussion-draft/.
32. M.B. Salgado Barca & R. Pallarés Rodríguez, *El patent box en España: Análisis del artículo 23 del TRLIS*, Quincena Fiscal Aránzadi 19, p. 76 (2014).
33. That is, the assets regulated by ES: *Ley* (Law) 17/2001 *de 7 de diciembre, de marcas(BOE núm. 294 de 8 diciembre 2001)* and ES: *Real Decreto Legislativo* (Legislative Decree) 1/1996 *de 12 de abril, por el que se aprueba el texto refundido de la Ley de Propiedad Intelectual(BOE núm. 97 de 22 de abril 1996)*.
34. These categories can be inferred from the tax rulings issued by the *DGT*. *See* E. Sanz Gadea, *El impuesto sobre sociedades en 2013 (III). Incentivos fiscales*, Revista Contabilidad y Tributación – CEF 375, pp. 9-10 (2014).

valent" to patents in terms of their effect on innovation, for example, technical improvements in industrial processes, social benefits, etc. In the opinion of Gadea (2014),[35] the scope of IP in respect of the patent box regime is broader than IP assets created in undertaking R&D (&I) activities in terms of the R&D (&I) tax credit in article 35 of the LIS. At the same time, the scope is narrower than that set out in article 12 of the OECD Model.[36]

In this context, a relevant point with regard to legal certainty is the different levels of clarity depending on every eligible an IP asset. On the one hand, the fact that patents, drawings, models and plans have their own legal system and scope of protection under specific IP laws provides taxpayers with greater certainty in applying for the patent box regime. On the other hand, the lack of specific regulations and the absence of a concept in the Spanish system in respect of know-how imply that taxpayers face a degree of uncertainty with regard to whether or not the undisclosed commercial information is eligible for the patent box regime. This uncertainty has been addressed by the DGT in its most recent Tax Rulings.[37]

### 3.4. The base for the patent box

As stated in section 3.1., in September 2013, the patent box regime was extended to encompass income derived from the transfer of IP assets. Consequently, both royalties derived from the licensing of intangibles and capital gains derived from the sale of intangibles may qualify for the patent box regime.[38] In this respect, it should be noted that, in both cases, the income to be included in the base for the patent box regime is the net income and the gross income.[39]

On the one hand, royalties do not include the "embedded royalties".[40] These are the hypothetical licence fee payments that a taxpayer would have received had the IP assets been used by the taxpayer itself in the manufacture of patented products. On the other hand, the benefits of the patent box regime apply to income derived from transfers of IP when a transaction is not between related parties. In this way, capital gains derived from a contract in respect of the sale of a patent between related entities do not benefit from the patent box regime. In contrast, with regard to a licence contract between related parties, royalties resulting from such a transaction qualify for the patent box regime. Despite this, the Spanish transfer pricing rules may apply in cases where the income is received from related parties.

With regard to the determination of the base for the patent box regime, income generated by IP benefits from a tax allowance that is related the tax base. The following formula is used for this purpose:

$$60\% \times \frac{\text{Direct expenditures related to the IP creation (increased up to 30\%)}}{\text{Overall expenditures related to the IP creation}}$$

In the same vein as Action 5 of the OECD Base Erosion and Profit Shifting (BEPS) Action Plan,[41] under this formula, the numerator is integrated with regard to the qualifying expenditure, which is defined as the expenditure directly related to the creation of the IP asset. In particular, this includes R&D (&I) expenditure incurred by a taxpayer and expenditure in respect of unrelated-party outsourcing. In contrast, the denominator is integrated with regard to the overall expenditure, which includes both of the categories previously referred to, as well as acquisition costs and expenditure in respect of related-party outsourcing. In no circumstances can financial expenses, depreciation in respect of fixed assets and other expenses that are not associated with the creation of the IP be included in the formula. As a result, taxpayers can only benefit from the patent box regime to the extent that they themselves have incurred the qualifying R&D (&I) expenditure in respect of deriving the IP income.[42]

With regard to qualifying expenditure in the formula, i.e. the numerator, the Spanish legislator has decided in favour of increasing qualifying expenditure up to 30% where such expenditure does not exceed the overall expenditure. Following the OECD's nexus approach, the Spanish formula is intended to benefit taxpayers that undertake R&D (&I) activities themselves, but do not penalize taxpayers excessively for acquiring IP or outsourcing R&D (&I) activities to related parties. This is probably because such taxpayers may themselves still be responsible for much of the value creation activities. Obviously, the tax benefit would not have been as generous had the taxpayer itself undertaken the R&D (&I).

35. Sanz Gadea, *supra* n. 34, at 10.
36. *OECD Model Tax Convention on Income and on Capital* (26 July 2014), Models IBFD.
37. *See*, inter alia, the following tax rulings issued by the DGT: ES: DGT, 25 Sept. 2015, No. V2788-15; ES: DGT, 26 June 2015, No. V2002-15; ES: DGT, 29 April 2015, No. V1368-15; ES: DGT, 9 Feb. 2015, No. V0522-15; and ES: DGT, 9 Feb. 2015, No. V0510-15.
38. With regard to the regional patent box regime in Guipúzcoa, Biscay, Alava and Navarre, qualifying income only refers to royalties or licence fee payments. In this regard, the four regimes state that transfers of IP should be temporary in nature and must not involve the alienation of IP.
39. According to OECD, *supra* n. 20, at 29, income benefiting from a patent box regime should be: (1) proportionate; and (2) limited to IP income. With regard to point (1), income that benefits from a patent box regime should not be disproportionately high, given the percentage of qualifying expenditures undertaken by qualifying taxpayers. This means that income should not be defined as the gross income. With regard to point (2), income should only include income that is derived from an IP asset, which may include royalties, capital gains and other income derived from the sale of an IP asset.
40. According to F. Alonso Murillo, *Spain*, in IFA, *supra* n. 4, at sec. 4.1., the Spanish patent box regime "has never been applicable to 'embedded royalties', and the current legal regime does not subject it to a quantitative limit".
41. OECD, *supra* n. 20, at 24.
42. In contrast, the regional patent box regimes in Guipúzcoa, Biscay, Alava and Navarre do not apply a formula based on the nexus approach. Under these patent box regimes, 70% of the income derived from contracts in respect of IP licences is included in the tax base. That is, the regional patent box regimes grant a 30% allowance in respect of the tax base regarding IP income. Consequently, these regimes do not link the income receiving benefits to the expenditure directly connected with the creation of the IP. However, the four regional patent box regimes do grant an enhanced allowance with regard to self-developed R&D (&I) processes. In particular, where a taxpayer has itself developed the IP asset, the taxpayer can apply for a 60% allowance. As a result, the taxpayer only includes 40% of the IP income in the tax base. Consequently, a taxpayer may qualify for an additional benefit when the taxpayer undertakes its own R&D (&I) activities.

## 4. Conclusions

As noted in section 1., the Spanish tax system adopts a broad scope with regard to R&D (&I) activities as companies may apply input and output incentives in respect of such activities. That is, tax expenditure covers all of the R&D (&I) processes "from the idea to the market". However, this broad scope could be questioned in the light of tax fairness.

With regard to the tax credit in respect of R&D &I activities, it should be noted that this intended not only to encourage R&D (&I) activities, but also technological innovation. Nevertheless, better treatment is granted for R&D (&I) activities. In the light of legal certainty, it is not always easy for companies to distinguish R&D (&I) from other scientific activities. In addition, even if Spanish business primarily consists of SMEs,[43] there are no special tax measures to stimulate investment by SMEs in R&D (&I).[44] In this context, the tax reform of November 2014 was a good opportunity to provide, first, a clearer definition of the concept of R&D (&I) for tax purposes and, second, a more flexible scheme for SMEs.[45]

With regard to the patent box regime, the pioneering approach of Spain in aligning the regime with the nexus approach should be noted. In this way, the patent box regime grants benefits when there is a substantial activity in respect of R&D (&I). As the Spanish patent box regime is more restrictive than the OECD's nexus approach, it does, however, raise the question as to whether or not this is the best regime for Spanish companies in terms of competitiveness.

In conclusion, there is a favourable tax climate for R&D (&I) in Spain, but there is room for reform to provide a more effective, clear and competitive scheme.

43. According to the *Informe ESEE 2013*, approximately 24% of Spanish SMEs undertook R&D (&I) activities in 2013, while 72.8% of Spanish MNEs developed R&D (&I) processes in 2013. The *Fundación SEPI* issued this report in February 2015, which is available at www.fundacionsepi.es/investigacion/esee/LasEmpresasIndustriales2013.pdf (accessed 25 April 2016).
44. For instance, in France, a tax credit in respect of innovation undertaken by SMEs has been granted since 2013 and small companies may apply for a special regime established in 2004, the *Jeune Entreprise Innovante*.
45. In this respect, *see* E. Gil García, *Los incentivos fiscales a la I+D+i a la luz de la reforma tributaria: la deducción por actividades de investigación, desarrollo e innovación tecnológica y el régimen del patent box*, Documentos de Trabajo del Instituto de Estudios Fiscales 10 (2015).